

Overseas Investments in UK Property

Practical Tax Guide from CMS

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CMS Tax

Internationally, CMS has over 500 tax lawyers supported by strong technical tax intelligence teams that identify developments in tax law and policy affecting your business. This multi-disciplinary approach helps clients develop robust structures that maximise tax effectiveness in alignment with their commercial strategy through a “one-stop shop”.

In the UK, our market-leading real estate tax practice is one of the biggest in any law firm in the country. We are an integral part of the Legal 500 and Chambers Band 1 ranked CMS Real Estate Practice and Real Estate Funds Practice. We have a wealth of experience advising on the acquisition, holding, development and disposal of UK real estate assets. Our technical expertise combined with our knowledge of the industry enables us to advise a wide range of clients on making investments into the UK real estate market.

We work with clients at an early stage (often pre-offer) advising on the optimum acquisition structure so that any tax costs can be modelled into pricing.

We are also at the forefront of developments in taxation with our partners sat on a number of industry bodies including the tax committees of the British Property Federation and the Association of Real Estate Funds.

This brochure summarises the key UK real estate tax considerations for investors coming into the UK market.



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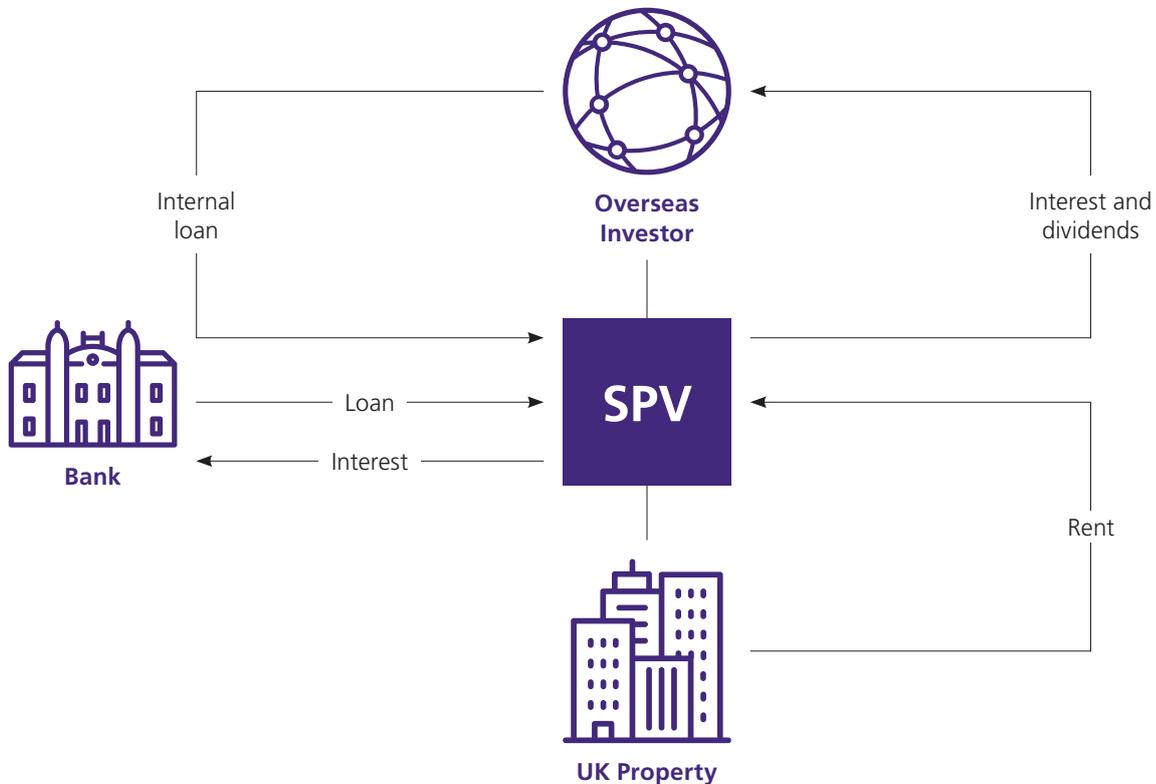


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Holding structure

Typical structure used by overseas investors to invest in UK property:



Special purpose vehicle (SPV)

A material amount of UK commercial property is already held in SPVs.

Where an SPV is acquired, consideration should be given as to whether it is a suitable vehicle to hold the property going forward. Investors often want to move the property into a new SPV so that they start with a “clean” structure for their period of ownership. Care should be taken to ensure that tax liabilities are not created on the transfer into the new SPV. Jersey and Guernsey unit trusts are a common and flexible choice of SPV, and are well known and understood by financial institutions, managers and administrators.

For regulatory reasons, the units in the trust must be held by at least two unitholders.

Typically, Jersey/Guernsey companies are incorporated to hold the units. The trusts are transparent for income purposes, with income being treated as received directly by the unit holders.

Equally, many commercial properties are held through offshore companies in the Channel Islands and Luxembourg.

Increasingly, due to various tax changes over recent years, domestic and non-UK investors are favouring SPVs that are incorporated and tax resident in the UK. Equally, Real Estate Investment Unit Trusts (REITs) are popular investment structures now due to the relaxation of various rules and conditions over the last few years.

For property traders, generally a UK company would be an appropriate choice of SPV.



Acquisition

Stamp duty land tax (SDLT)

SDLT is UK transfer tax payable on almost all direct real estate acquisitions in the UK. It is a liability of the buyer. The tax is charged at different rates according to the value of the transaction and has different thresholds for commercial and residential real estate (see below).

The buyer is required to file an SDLT return with the UK tax authority (HMRC) and the tax must be paid within 14 days of the date of completion of the transaction. In some situations, SDLT is payable earlier than completion (i.e. if the majority of the purchase price has been paid or the buyer takes possession of the property before completion). CMS will typically draft and file the SDLT return for clients.

Commercial

These rates apply to the relevant slice of the property price, such that the rate is generally referred to as being 5% for high-value transactions.

Property price	SDLT rate
£0 to £150,000	Zero
£150,001 to £250,000	2%
£250,000 +	5%

Many UK commercial real estate assets are held in SPVs. Often a sale will be of the SPV rather than the property itself. Whilst the additional work required increases the transaction costs (in terms of fees payable to advisers), it materially reduces the overall acquisition cost as no SDLT is payable. The SDLT saving is generally taken into account on pricing. An SPV acquisition requires a careful and thorough due diligence process to ensure that the structure established by the seller not only achieves that reduction in tax but also that the buyer does not suffer any unexpected tax consequences as a result of historic activity by the SPV.

Residential

The rates apply to the relevant slice of the consideration. An SDLT surcharge of 3% on each SDLT rate will generally apply where the residential property is acquired by an SPV or where the buyer is an individual that already owns a property. However, the 3% surcharge does not generally apply to purpose built student accommodation.

Certain acquisitions of residential property are subject to an additional 2% on each SDLT rate where the acquisition is by a non-UK investor, or by a UK SPV controlled by non-UK investors. REITs are not subject to this charge. In some cases, both the 2% and 3% additional rates can apply to a transaction. Again the 2% additional rate typically does not apply to purpose built student accommodation.

If six or more residential units are acquired as part of a single transaction (for example a block of flats) then they can be treated as commercial property and therefore subject to the lower commercial SDLT rates outlined above. The same lower commercial rates will apply for the acquisition of a mixed-use residential and commercial property.

Property price	SDLT rate	3% surcharge	2% surcharge
£0 to £250,000	0%	3%	5%
£250,001 to £925,000	5%	8%	10%
£925,001 to £1.5 million	10%	13%	15%
£1.5million and above	12%	15%	17%



Suntec REIT

CMS advised on the acquisition of a 50% interest in Phase One of Nova Victoria from Canada Pension Plan Investment Board for c£430m.



Stock Exchange Tower

CMS advised City Developments Limited on the purchase of 125 Old Broad Street for £385m, formerly known as Stock Exchange Tower.

Valued added tax (VAT)

VAT is a tax that is charged on most goods and services that VAT-registered businesses supply in the UK.

Commercial

Generally, the supply of buildings is exempt for VAT purposes. However, an owner of commercial real estate can (and normally does) choose to "opt to tax" its interest in a building, to treat any supplies it makes in relation to the building subject to VAT at the standard rate (currently 20%).

The benefit of opting to tax a building is that the owner can recover VAT on acquisition, maintenance and management costs that it is charged by suppliers. If the seller has made an option to tax, the sale is normally subject to VAT (unless it is a transfer of a going concern – see below). This VAT is generally recoverable by a buyer if it also opts to tax the property and charges VAT on rents going forward. In some instances, a buyer may choose not to opt to tax the property or may as a result of restrictions in the occupational leases not be entitled to opt to tax (i.e. where the relevant tenant cannot recover VAT, such as a bank).

The sale of a building which is leased to occupational tenants who pay rental income should be treated as a "transfer as a going concern" ("**TOGC**") such that no VAT should be payable on the purchase price. This is helpful not only from a cashflow perspective (as the buyer does not have to fund the VAT), but also from an SDLT perspective as SDLT is payable on VAT. The SDLT on the VAT is not recoverable.

To secure TOGC treatment in this case, provided the seller has opted to tax, the buyer must make its own option to tax and satisfy various other requirements prior to completion of the transaction. CMS can assist with preparing the option to tax and related VAT documentation which will need to be filed with HMRC.



Residential

No VAT is payable on the acquisition of residential property. It is either exempt, or subject to VAT at 0%.

Non-resident capital gains tax

Prior to April 2019, non-UK residents were not subject to UK tax on the disposal of commercial properties held as investments, or the disposal of non-UK SPVs holding UK properties as investments.

Following the changes in April 2019, non-residents are now subject to UK tax on gains realised through direct and indirect disposals of UK commercial property.

Only gains accruing from 5 April 2019 will be subject to tax. Provisions within the legislation allow for rebasing to the market value as at that date, or (if higher) the acquisition cost. This change aligns the UK with most other European jurisdictions.

Indirect disposals (being essentially the disposal of an SPV or an interest in an SPV) are subject to UK tax where the entity being disposed of is "property rich". An entity will be property rich if least 75% of its value derives from UK land. When the new rules were announced there was some concern that for holding structures with multiple layers, there would be multiple tax charges in respect of essentially the same economic gain. For example, on a disposal of an SPV, the seller would suffer tax on the gain realised on disposing of the SPV, and the SPV would have a latent taxable gain in respect of the property (i.e. broadly the market value less the SPV's acquisition cost in respect of the property, and any other enhancement expenditure). To address this issue, the UK government introduced the possibility for making certain elections.

In relation to Jersey/Guernsey unit trusts, for example, where certain conditions are met, an election can be made to treat the unit trust as transparent for the purposes of chargeable gains (the "**Transparency Election**"). A disposal of the unit trust is therefore treated as a disposal of the underlying property by the unitholders. The Transparency Election means that the unit trust will not have a latent taxable gain within it, such that on a sale of the unit trust, a buyer should not look to reduce the price.

Equally, for certain structures that are widely held, or fund structures, an election can be made that exempts the SPV and certain subsidiary entities from tax on gains (the "**Exemption Election**"). No tax is therefore paid within the structure, and is only payable when investors dispose of their interest in the structure or receive returns in relation to underlying disposals. Certain conditions must be met for an Exemption Election to be made, and there are various compliance requirements as a result of making it. The main benefits are that there should be no effective double taxation, and when SPVs are sold, the SPV should benefit from a step-up in its base cost in the property to its market value at that time (meaning there is no latent taxable gain within the SPV).

CMS can advise on the rates and how new holdings can be structured to mitigate the impact of these changes. Certain non-residents have been within the scope of UK tax on gains realised in respect of residential property since April 2015.

REITs

REITs are UK tax resident companies or groups that elect to enter the REIT regime. Provided the relevant conditions are met, REITs are exempt from UK corporation tax on rental profits and are (broadly) exempt from UK corporation tax on gains on disposals of investment properties.

Tax in respect of gains and rental profits is by way of withholding tax on distributions made to tax-paying investors. The withholding tax is at the basic rate of income tax, which is currently at 20%. For many non-UK investors, relief can be claimed under a Double Tax Agreement to reduce the tax cost to 15%. Such investors can therefore claim a partial refund of the tax withheld in the UK. Given the increase in UK corporation tax to 25% in April 2023, the ability to reduce the tax rate on UK rental profits and gains to 15% represents a material saving. For this reason, REITs are gaining in popularity in the UK.

To access the regime, the REIT must either be widely held, or controlled by an “institutional investor” which is a defined list that includes pension schemes, charities, certain insurance businesses and sovereign wealth funds. Prior to April 2022 the shares in the REIT had to be listed. The strict requirement has been removed for certain REITs controlled by institutional investors.

Taxation of Rental Income

Since 5 April 2020, non-resident companies owning UK property are no longer subject to UK income tax and instead are subject to UK corporation tax on net rental income. The current rate of UK corporation tax is 25%. Non-corporate investors are generally subject to UK tax at higher rates.

Tenants/letting agents are required to deduct tax at 20% from the payment of rent and pay it to HMRC. Non-resident owners can apply to receive rental income gross by registering under the non-residents’ landlord scheme. This therefore eliminates any UK withholding tax obligations on the rental income the owner will receive. CMS can prepare and submit this application. It is important that the application is submitted to HMRC as early as possible.

Tax deductions – interest where debt on Property

In calculating the owner’s taxable income, the owner will get a deduction for expenses wholly and exclusively incurred for the purposes of its property rental business.

Prior to April 2020, this included deductions for any arm’s-length interest payments on shareholder borrowing and all interest on third party debt taken out to acquire the property.



In April 2017, UK companies became subject to rules restricting deductions in respect of interest expenses. Since April 2020, non-UK companies have been subject to these rules. The general rule is that interest deductions are limited to 30% of the taxpayer's taxable earnings before tax-interest, depreciation and amortisation ("EBITDA").

This is subject to two general relaxations to the rules as follows:

- groups will be entitled to a £2,000,000 de minimis per year; and
- (if higher than 30%) a group may apply a percentage based on the ratio of the group's net interest expense to group EBITDA.

A further exemption from the general rule applies in the case of public benefit infrastructure projects, which can include certain real estate assets. Where this exemption is claimed, interest on all third-party debt can be deducted.

Tax deductions – Capital Allowances

Under UK tax rules there is no relief for depreciation, which is solely an accounting concept. Capital allowances are a form of tax relief for depreciation in respect of expenditure on plant and machinery within a property.

They will generally be available as a deduction from the owner's taxable income.

The rate of depreciation for tax purposes per year (on a reducing balance basis) is:

- 6% for integral features (including electrical and cold water systems, heating and air cooling systems, lifts, escalators and external solar shading); and
- 18% for all other qualifying plant and machinery.

More recently, the UK government introduced more beneficial first-year allowances. Originally introduced on a temporary basis, these were made permanent in 2024. These allow:

- 50% of the cost of expenditure on certain integral features; and
- 100% of the expenditure for other qualifying plant and machinery (known as "full expensing") to be deducted in the year the expenditure occurs.

Should full expensing be used, the 18% year-on-year tax depreciation will not be available. For expenditure qualifying for the 50% first-year rate, the remaining expenditure can qualify for the 6% year-on-year tax depreciation rate.

The rules in relation to the transfer of capital allowances are complex and the position needs to be considered on a case-by-case basis. CMS can advise on this in relation to property acquisitions and disposals.

It is often the case that on the acquisition of a property, the parties can elect for part of the purchase price to be apportioned to plant and machinery in the property. It is this amount that will determine the extent of the capital allowances available to the owner going forwards. This is achieved by the parties entering into a "section 198 election" and submitting this to HMRC. Typically, this amount will be the amount of capital allowances that the seller has not yet claimed.

In some instances, the seller will not be entitled to claim capital allowances (i.e. pension funds, charities or developers who hold the property as trading stock). In those cases, any capital allowances pass to the buyer automatically.

Prior to 29 October 2018, no tax relief was given to capital expenditure incurred on constructing or renovating the structure of a building. Structures and Buildings Allowances are a new form of capital allowances designed to write off the construction costs of a building (excluding plant and machinery). They are available to all new commercial property owners where the development commences after 29 October 2018.

The relief is a simple straight-line deduction against profits at a rate of 3% of the construction costs, over a period of 33.3 years. On a sale within that 33.3-year period, the benefit of any unused allowance can transfer to a new buyer. Capital allowances are not available in respect of the land itself.

Annual Tax on Enveloped Dwellings (ATED)

Where an SPV acquires residential property with a value in excess of £500,000, it will be within the scope of ATED. ATED is an annual charge payable by the SPV and is calculated by reference to the value of the property. Relief from ATED can be claimed where the property is used for the purposes of a property trading business or for a rental business, provided that is not occupied at any time by a person connected with the SPV. The relief should be claimed in a return that must be submitted to HMRC.



Development

There are various tax considerations in respect of developments of UK real estate..

VAT

VAT is payable on development costs in relation to commercial property at the current rate of 20%. This VAT is recoverable by the property owner if it has opted to tax the property (see above), such that the VAT payment is a cashflow point rather than an actual cost.

Where residential property is being constructed from the ground up, the construction costs should be zero-rated (i.e. subject to VAT at 0%). Where residential property is developed for sale, the onward sale of the completed units will also generally be zero-rated, which enables the seller to recover the input VAT it has incurred on either acquiring the land, or costs associated with it (i.e. fees).

Where VAT is incurred in respect of land and construction works that will be used for private residential lettings, any VAT incurred is not generally recoverable (as it will relate to exempt supplies of residential letting). This can represent a material cost to the project. CMS can advise on how this VAT cost can be mitigated to ensure minimal VAT leakage.

Construction Industry Scheme (CIS)

The CIS is a tax deduction scheme that applies to payments for construction services. It was introduced originally to counter perceived tax avoidance in the UK construction industry.

The scheme effectively places a withholding obligation on the payer (known as the "Contractor") from payments made to someone for the provision or procurement of construction services (known as the "Sub-Contractor"). The obligation to make a deduction is determined by the status of the Sub-Contractor under the CIS. The Contractor must verify the status of the Sub-Contractor before making payment.

The deduction will be at the rate of 30% or 20% (depending on the status of the Sub-Contractor) and is applied to the proportion of the payment that relates to labour. It does not apply to payments that relate to the materials used for the works. The deductions are credited against the Sub-Contractor's own tax liabilities, assuming they pay tax on their trading profits. Typically, most established developers are registered under the CIS to receive payments gross, such that no deductions are required to be made. The Contractor will be required to file monthly CIS returns with HMRC.

Residential Property Developer Tax (RPDT)

RPDT is a revenue raising measure to help fund remediation works for unsafe cladding on high rise residential buildings, a major part of the government's Building Safety Package developed in light of the tragic fire at Grenfell in 2017. It came into effect on 1 April 2022.

In broad terms, RPDT targets companies or corporate groups that undertake UK residential property development activities and generate profits in an accounting period that exceed an annual allowance of £25 million. It imposes a tax on profits (at a rate of 4%), which are computed as for corporation tax, with adjustments to ensure the full extent of profits are captured. For instance, no deductions would be available for financing costs.

Sale

Many of the taxes mentioned above need to be considered on the sale of a property asset as well.

SDLT

While SDLT is a buyer's liability, any SDLT that the buyer is required to pay is likely to be factored into the amount they are willing and able to pay for the property. Where the exit is by way of a sale of the SPV, so that no SDLT is payable by the buyer, this could increase the amount a buyer is willing to pay.

VAT

It is for the seller to determine the correct VAT treatment of any sale and to charge the buyer appropriately. It is therefore important to get advice on this at an early stage, and CMS can advise on the correct VAT treatment. As stated above, in practice, the majority of sales will be outside the scope of VAT as they will be a TOGC.

Where a sale is by way of a TOGC, you will be required to retain VAT records and provide access to these to the buyer for a period of time after completion.

Direct Tax

On sale, it will be important to consider either the capital gains tax or corporation tax liability on any profits generated on the disposal and to file any necessary returns and pay the appropriate tax to HMRC.



1 & 2 New Ludgate

CMS advised Sun Venture on its £552m acquisition of 1 & 2 New Ludgate from Landsec. Occupying a prominent 1.5-acre site next to the Old Bailey, the asset provides a combined 389,615 sq ft of office and retail accommodation.



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